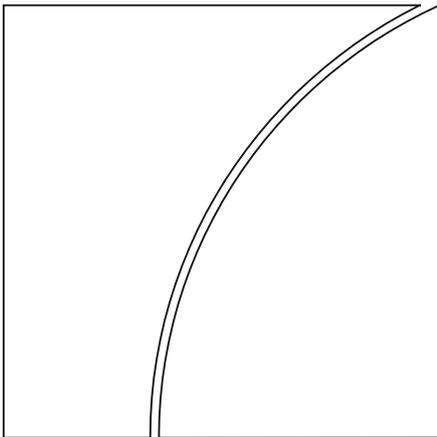


# Basel Committee on Banking Supervision



## Regulatory Consistency Assessment Programme (RCAP)

### Assessment of Basel III LCR regulations – South Africa

June 2015



BANK FOR INTERNATIONAL SETTLEMENTS

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## Glossary

ALA	Alternative Liquidity Approach
BCBS	Basel Committee on Banking Supervision
BCPs	Basel Core Principles for Effective Banking Supervision
BIS	Bank for International Settlements
BSD	(South African Reserve Bank's) Banking Supervision Department
C	Compliant (grade)
CET1	Common Equity Tier 1
CLF	Committed Liquidity Facility
D-SIB	Domestic systemically important bank
FAQ	Frequently asked question
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessment
G-SIB	Global systemically important bank
LC	Largely compliant (grade)
LCR	Liquidity Coverage Ratio
MNC	Materially non-compliant (grade)
na	Not applicable
NC	Non-compliant (grade)
RCAP	Regulatory Consistency Assessment Programme
R-CLF	Restricted-use Committed Liquidity Facility
SARB	South African Reserve Bank
SIG	Supervision and Implementation Group
SREP	Supervisory review and evaluation process (South Africa)
ZAR	South African rand

## Preface

The Basel Committee on Banking Supervision sets a high priority on the implementation of regulatory standards underpinning the Basel III framework. The prudential benefits of adopting the framework can only fully accrue if these standards are implemented consistently by all member jurisdictions. Through its Regulatory Consistency Assessment Programme (RCAP), the Basel Committee monitors, assesses and evaluates its members' implementation of the Basel framework.

The assessments under the RCAP aim to ensure that each member jurisdiction adopts the Basel III framework in a manner consistent with the framework's letter and spirit. The framework's intent is to establish prudential requirements that are based on a sound, transparent and well defined set of regulations that will help strengthen the international banking system, improve market confidence in regulatory ratios and ensure an international level playing field.

This report presents the findings of the RCAP Assessment Team on the domestic adoption of the Basel III Liquidity Coverage Ratio (LCR) in South Africa.<sup>1</sup> The assessment focuses on the regulatory adoption applied to South African banks that are internationally or regionally active, and of significance to domestic financial stability. It was based primarily on the domestic regulations issued over 2012, 2013 and 2014. Over the assessment period, South African authorities made revisions based on issues identified by the Assessment Team. These revised regulations were issued by the South African authorities in April 2015.

The RCAP Assessment Team was led by Mr Frank Pierschel, Head of International Policy/Affairs – Banking Supervision, at Germany's Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin). The LCR Assessment Team comprised two technical experts from Japan and Switzerland (Annex 1). The work was coordinated by the Basel Committee Secretariat with support from BaFin staff. The main counterpart for the assessment was the South African Reserve Bank (SARB).

The assessment is based upon information provided up to 10 April 2015, and the work was carried out in three phases: (i) completion of an RCAP questionnaire (self-assessment) by the SARB; (ii) an off- and on-site assessment by the Assessment Team; and (iii) a post-assessment review phase. The on-site visit included discussions with SARB counterparts and representatives from South African banks. This provided the Assessment Team with a deeper understanding of the domestic implementation of the LCR and supervisory practices. The third phase consisted of a two-stage technical review of the assessment findings; first, by an independent RCAP Review Team and feedback from the Basel Committee's Supervision and Implementation Group (SIG), and second, by the RCAP Peer Review Board and the Basel Committee. This two-step process is a key instrument to provide quality control and ensure the integrity of the assessment findings.

The scope of the assessment was limited to the consistency and completeness of the domestic regulations with respect to the Basel framework. Where domestic regulations and provisions were identified to be inconsistent with the Basel framework, those deviations were evaluated for their current and potential impact on the LCRs for a sample of internationally active banks in South Africa. The overall outcome was based on the materiality findings and the use of expert judgment. Issues relating to the adequacy of prudential outcomes, liquidity levels of individual banks or the SARB's supervisory effectiveness were not in the scope of this assessment.

<sup>1</sup> This report complements the RCAP assessment report of South Africa's adoption of the Basel III risk-based capital standards.

This report is divided into three sections and a set of annexes: (i) an executive summary including a statement from the SARB; (ii) the assessment findings, including a description of the assessment, scope and methodology; and (iii) the details of the assessment findings along with other assessment observations.

The RCAP Assessment Team sincerely thanks Mr René van Wyk, Mr Rob Urry, Ms Mardolene van Hoven and the staff of the SARB for the professional and efficient cooperation with counterparts through the assessment process. The comprehensive discussions with the SARB helped the team arrive at their assessment. The Assessment Team hopes that the RCAP exercise contributes to further strengthening the domestic prudential framework and supervisory practices.

## Executive summary

The LCR framework was implemented by the South African Reserve Bank (SARB) via Regulations issued in 2012, and subsequently updated via Directives over 2013 and 2014. The LCR applies to all banks and/or banking groups in South Africa.

The RCAP Assessment Team finds the SARB's LCR regulations to be compliant with the framework prescribed under Basel III, including both subcomponents, ie the LCR standard and the LCR disclosure framework. The team initially identified two deviations, related to the detailed computation of the LCR and the scope of application. These two findings were rectified by amendments by the SARB by the cutoff date (see Annex 5).

The team had two observations, both of which relate to the implementation of the Alternative Liquidity Approach (ALA) outlined in the LCR framework.

The SARB also described its implementation of the Basel III liquidity risk monitoring tools, including that for monitoring intraday liquidity risk (see Annex 9). Furthermore, the SARB discussed its approach to implementing the Committee's *Principles for Sound Liquidity Risk Management and Supervision* (see Annex 10). While not within the scope of assessment, these discussions clarify how authorities implement certain aspects of the Basel III framework.

The assessment raised two main issues where further clarification from the Basel Committee is sought. The first relates to the use of the ALA treatment outlined in the LCR framework. The Committee developed the ALA framework for jurisdictions with structurally insufficient supplies of defined high-quality liquid assets (HQLA) in domestic currency. Given the idiosyncrasies of the South African financial system, the SARB has created a Committed Liquidity Facility (CLF) for banks as a substitute for Level 2A assets. The LCR framework notes that eligibility for use of an ALA approach will be subject to an independent peer review process. The RCAP assessment described in this report did not assess South Africa's eligibility to use an ALA framework, and thus seeks guidance from the Committee on how this peer review process would operate. Further, the Assessment Team notes that the LCR framework requires supervisory oversight of banks' processes for distinguishing between different classes of deposits. Enhanced information exchange on supervisory practices would be useful in helping supervisors refine their approach (see Annex 11).

Finally, although not considered deviations, the Assessment Team recommends follow-up on two features of the SARB's framework, namely the scope of application and the disclosure framework (see Annex 12).

## Response from the South African authorities

The SARB appreciates the opportunity for South Africa to be among the first jurisdictions to be assessed under the RCAP for their implementation of the Basel III LCR standards, and would like to thank the Assessment Team, under the leadership of Frank Pierschel, for the dedication and professionalism with which the RCAP review of South Africa was undertaken.

Legislation enforcing the LCR in South Africa was implemented via the Banks Act, the "Regulations relating to Banks" (the Regulations) and Banks Act Directives 6, 7, 8 and 11, all issued in 2014, updating the prior domestic banking legislation on liquidity risk to align it with the finalised BCBS standards for the LCR.

Whilst the South African regulation was prepared using the Basel standard as guidance, the Assessment Team identified a limited number of deviations of the South African regulations from the Basel standard that were discussed extensively during the meetings. Subsequently the SARB made appropriate changes to the regulations to fully comply with the Basel requirements or otherwise clarified the rationale behind super-equivalent or non-material differences (eg conversion of the EUR 1 million limit for SMEs to local currency).

The SARB considers the RCAP a valuable process, which will lead to consistent regulatory standards amongst BCBS members and elucidate components of the framework that cause interpretive difficulties and require refinement.

Areas that the SARB has identified as requiring further clarity from the Basel Committee include the methodology for assessing the validity of operational deposits and the supervisory approval thereof; and the scope of consolidation relating to non-material, non-banking entities or group entities in jurisdictions that have not implemented Basel III. We also note that these items are included in the ongoing work of the Working Group on Liquidity as part of the post-implementation work that the working group is conducting.

# 1. Assessment context and main assessment findings

## 1.1. Context

### Status of implementation

South Africa implemented the Basel III liquidity framework (Annex 2) for monitoring purposes as from 1 January 2013. However, this was based on the 2010 version of the LCR framework. The final legislation enforcing the LCR was implemented via the Regulations and Banks Act, Directives 6, 7, 8 and 11, all issued in 2014. During 2015, the SARB amended the Regulations, via Government Gazette, and issued further Circulars and Directives, updating the domestic legislation to align it with the finalised LCR and taking into account the discussions held during the RCAP.

The Basel Committee's *Principles for sound liquidity risk management and supervision* were implemented into the domestic framework by incorporating the necessary requirements in Regulations 26 and 39, which deal with the process of corporate governance and which include, in particular, the requirements for a bank to have robust risk management processes, practices, procedures and policies in place to address liquidity risk. The SARB's Banking Supervision Department (BSD) has historically implemented a liquidity risk return (Form BA 300), submitted to it by all banks on a monthly basis as per a standard reporting template, to monitor individual banks' liquidity risk exposures. This reporting template was extended to include the LCR as it was implemented. These liquidity risk returns include the measurement of the contractual, business-as-usual and stress mismatches, depositor concentration, sources of stress funding and the foreign exchange maturity ladder. These requirements are applicable to all banks.

Under the South African regulations, the Basel liquidity standards are applied to all banking entities within the group on an aggregated basis. The Banks Act and the Regulations apply uniformly to all 31 banks and/or banking groups in South Africa.

### Regulatory system and model of supervision

The SARB was established in 1921 and is responsible for ensuring the overall soundness of the South African money, banking and financial system. This includes specific responsibilities for monetary policy, banking supervision and the currency. The SARB is currently undergoing changes in the regulatory and supervisory framework for the overall financial system. The SARB is currently responsible for banking regulation and prudential supervision, and the Financial Services Board (FSB) regulates and supervises the non-banking financial services industry, including insurance companies. Oversight of fund managers and stock exchanges is shared by the FSB and the Johannesburg Stock Exchange. However, the authorities are planning to adopt a "Twin Peaks" model, expected to be finalised during 2016, that includes a Prudential Authority and a Financial Sector Conduct Authority.

In 2015, the IMF published a Financial Sector Assessment Program (FSAP) for South Africa. It found that South Africa has a high level of compliance with the Basel Core Principles for Effective Banking Supervision (BCPs).<sup>2</sup> The report noted that the SARB, in particular, had made significant improvements since the last assessment five years prior, including expansion of staffing and remedying shortcomings in domestic regulation. Amongst the BCPs, South Africa was found to be compliant with

<sup>2</sup> International Monetary Fund, *South Africa Financial Sector Assessment Program: Basel Core Principles for Effective Banking Supervision, detailed assessment of compliance*, February 2015.

Principle 24 on liquidity risk. In addition to the Basel III liquidity standards, South Africa has two domestic prudential liquidity standards for banks, namely, a cash reserve requirement and a liquid asset requirement. The Regulations require daily reporting of a bank's LCR and liquid asset positions, which is monitored by the BSD.

### Financial system structure

As at 31 December 2014, the South African banking system had total assets of ZAR 4,178,699 million, or 107.1% of GDP, among the largest for emerging market economies. The South African banking system comprises 31 deposit-taking institutions. More than 86.8% of total banking assets are domestic, although 20 foreign banks have operations in South Africa. The largest five banks constitute 91% of the total banking assets in South Africa. These banks are also active within Africa, with 9.7% of their assets at a bank controlling company level represented by banking subsidiaries in other African countries.

Banks are largely funded by domestic deposits, with 25% retail and 75% wholesale deposits, of which 43% are related to corporate deposits. Non-bank financial institutions, such as pension funds and money market funds, play a strong role in the South African financial system, including as creditors to banks. The average contractual maturity of funding is greater than seven years. Foreign currency liabilities are 8% of total obligations. Capital markets are supported by high participation by non-bank financial institutions, particularly those that engage in long-term investment strategies, and foreign investors. However, the corporate bond and equity markets are still considered illiquid as these instruments are typically held by non-bank entities and not actively traded as compared to government bonds. The average market capitalisation of the bond and equity markets was 57% and 288% of GDP, respectively, in 2014.

Banks have been subject to national liquidity requirements since 1993. This measure is defined as the liquid asset requirement, and compliance is measured on a monthly basis based on a daily average basis. The ratio of available liquid assets to required liquid assets for the sector is disclosed on a monthly basis. In the fourth quarter of 2014, for a sample of nine banks, national liquidity ratios ranged from 145% to over 670%, with a simple average of 338%. For comparison, the reported LCR for these banks ranged from 62% to over 1,300% during the same period, with a weighted average of 76% (see Annex 7).

## 1.2. Structure and enforceability of prudential regulation

In South Africa, the Basel capital framework has been implemented through a three-tier regulatory structure (see Annex 3). The Tier 1 legislation consists of an amendment of a parliamentary Act called "Banks Act, 1990". While the Banks Act containing the key Basel provisions serves as the primary legislation, the operational details that constitute the bulk of the Basel framework are contained in the Tier 2 legislation called "Regulations relating to Banks (the Regulations)" issued through Government Gazette No. R. 35950 dated 12 December 2012 and subsequently amended through Government Gazette No. 38682. The Banks Act and the Regulations framed thereunder are administered by the SARB.

The Banks Act provides enabling legislation that allows the SARB to prescribe the minimum requirements and selected supervisory review and evaluation process (SREP) in the Regulations relating to Banks and in directives, circulars and guidance notes issued in terms of the Banks Act. The Regulations specify the internationally agreed minimum prudential and other requirements necessary to implement and comply with internationally agreed frameworks, such as Basel II, Basel 2.5 and Basel III.

Other major regulatory instruments used to implement the Basel liquidity standards in South Africa include Directives, Circulars and Guidance Notes issued by the SARB (generally referred to as Tier 3 legislation). The purpose of these instruments is to provide further direction, interpretation, guidance or clarification, and information on best practices. In terms of Section 6 of the Banks Act, the Directives and Circulars are binding in nature. Moreover, the SARB's Financial Markets department issues

operational notices to facilitate market operations. These operational notices are not legally binding, but are often used to facilitate contractual arrangements.<sup>3</sup>

Being an act passed by the South African parliament, the Banks Act is the binding act, and so are the regulations framed under this Act. The Directives and Circulars are issued by the Registrar under the powers available under the Banks Act and are therefore binding in nature. Depending upon the nature of the matter, the Directives may be replaced by Regulations in due course. The objective of the Guidance Notes is to provide elaborate guidance on more technical matters to facilitate and ensure accurate and uniform implementation of the regulations across all banks in the country. Though the Guidance Notes are not binding, it was understood from the SARB authorities and banking associations that these are normally adhered to by the banks. All these instruments were relied upon for the assessment. Further details of the assessment of their binding nature are provided in Annex 6. Annex 3 lists the regulatory instruments implementing Basel III capital standards in South Africa. All these instruments are hitherto collectively referred to as "South African regulations".

### 1.3. Scope of the LCR assessment

The Assessment Team took into consideration the regulatory instruments and other documents mentioned in Annex 3 that implement and bring into force the Basel LCR framework in South Africa. By the agreed cutoff date for the assessment of 10 April 2015, the assessment focused on two aspects:

- (a) comparison of the South African regulations with the LCR and disclosure requirements under the Basel framework to ascertain if all the required provisions have been adopted (*completeness* of the regulations); and
- (b) differences in substance between the above South African regulations relative to the Basel framework and their significance (*consistency* of the regulations).

The assessment did not evaluate the adequacy of liquidity or resilience of the banking system in South Africa, nor the supervisory effectiveness of the relevant supervising agencies. The assessment also did not involve verification of the actual implementation by banks.

#### Assessment grading and methodology

The outcome of the assessment was summarised using a four-grade scale, for each of the two key components of the Basel framework (LCR, and LCR disclosure requirements) and for the overall assessment of compliance: compliant, largely compliant, materially non-compliant and non-compliant. The materiality of the deviations was assessed in terms of their current or, where applicable, potential future impact on LCRs of the banks in the sample. The impact analysis did not extend to the wider South African economy or broader financial stability-related systemic risk.

The non-quantifiable assessment findings were discussed with the SARB and outcomes were guided by expert judgment. The Basel Committee guidance on principles to guide non-quantifiable findings was also kept in view.

Ultimately, the Assessment Team relied on the general principle that the burden of proof rests with the assessed jurisdiction to show that a finding is not material or potentially material. Wherever stronger than the minimum Basel requirements, elements of the South African regulations are fully in

<sup>3</sup> While these documents are not part of prudential regulations, Addendum 1 of the current operational notice serves to facilitate implementation of the Committed Liquidity Facility that is eligible as a Level 2A high-quality liquid asset. See below.

line with the nature of the international agreements, which are considered minima. However, per the RCAP methodology these “super-equivalent” measures were not considered as compensating for inconsistencies or gaps identified elsewhere, unless they fully and directly address the identified inconsistencies or gaps.

In cases where data limitations existed for quantifiable gaps, the team assessed materiality based on proxies such as the level of exposure to the affected asset class, the number of banks engaged in specific business activities, data from public sources, results of impact studies or other similar types of information made available by the assessed jurisdiction. In these cases, the Assessment Team used its collective expert judgment to form a best efforts estimate of the impact on banks’ LCRs.

Summary information on the materiality aspects of the assessment is provided in Annex 8. Areas where the SARB regulations are stricter than the Basel requirements are listed in Annex 13.

### 1.4. Main findings

A summary of the findings is given below. This should be read along with the list of detailed findings in Section 2, as well as other observations related to the South African system. The issues that were rectified during the assessment period are listed in Annex 5.

To foster more consistent implementation, the Assessment Team has identified two issues that would benefit from further guidance and clarifications from the Basel Committee. These are listed in Annex 11.

Summary assessment grading	Table 1
<b>Key components of the Basel LCR framework</b>	<b>Grade</b>
<b>Overall grade:</b>	<b>C</b>
LCR subcomponents (as agreed by the Basel Committee in September 2014)	
<b>Liquidity Coverage Ratio regulation</b>	<b>C</b>
<b>LCR disclosure standards</b>	<b>C</b>

Definition of the grades): **compliant (C)**: all minimum Basel provisions have been satisfied and no material differences have been found that would give rise to prudential concerns or provide a competitive advantage to internationally active banks; **largely compliant (LC)**: only minor provisions have not been satisfied and differences that have a limited impact on financial stability or the international level playing field have been identified; **materially non-compliant (MNC)**: key provisions of the framework have not been satisfied or differences that could materially impact capital ratios; **non-compliant (NC)**: the regulation has not been adopted or differences that could severely impact capital ratios and financial stability or international level playing field have been identified.

Colour code:

Compliant	C
Largely compliant	LC
Materially non-compliant	MNC
Non-compliant	NC

### Main findings by component

#### *Scope of application and transitional arrangements*

Overall, the Assessment Team finds the scope of application and transitional arrangements to be compliant with the Basel standards. The domestic regulations to implement the LCR were published in

2012 and updated through Directives during 2013 and 2014, and apply on a solo and consolidated basis to all 31 banks. The South African authorities have followed the phase-in approach provided for in the LCR standard.

With regard to the scope of application, the domestic regulations apply the LCR standard to all banking entities within the banking group on an aggregated basis. However, the SARB has made provisions for exclusion of certain other financial institutions where they are assessed as non-significant exposures, as permitted by the LCR standard. Analyses showed that these excluded entities are not material. As these exposures are captured as potential outflows in the LCR denominator, the Assessment Team does not consider this treatment a deviation in terms of the LCR framework.

#### *High-quality liquid assets (numerator)*

South Africa was found to be compliant with the LCR requirements for high-quality liquid assets (HQLA). Due to a structural insufficiency of rand-denominated qualifying assets, the SARB allows for two alternative liquidity approaches (ALAs), a committed liquidity facility (CLF) and additional use of foreign currency assets to cover rand-denominated net cash outflows. The large domestic banks signed bilateral CLF contracts with the SARB at end-2014. Use of the CLF is limited to up to 40% of total HQLA requirements, ie effectively a substitute for Level 2A assets. It is expected that smaller banks, with insufficient high-quality collateral to apply for the CLF, will make use of the other ALA option.

#### *Outflows (denominator)*

South Africa was assessed as compliant with respect to the outflows.

#### *Inflows (denominator)*

South Africa was assessed as compliant with respect to the inflows.

#### LCR disclosure standard

South Africa was assessed as compliant with the LCR disclosure standard. The SARB has indicated that banks complete the required LCR template for both reporting and disclosure purposes. However, the authorities have indicated that this template will be formally incorporated into regulations over 2015 (see Annex 12). As the template is found in the reporting requirements, the Assessment Team did not find this to be a deviation.

## 2. Detailed findings

The component by component details of the assessment of compliance with the LCR regulations and disclosure standard of the Basel framework are detailed in this part of the report.

This section describes the findings that are considered as deviations. These deviations were assessed for their current and potential materiality on the LCR ratios of banks in the sample based on data collected from banks and other information provided by the SARB, or by expert judgment. The final conclusions on materiality reflect the Assessment Team's judgment taking into account all this information.

## 2.1. LCR

Section grade	Compliant
Summary	The adoption of the LCR is assessed as compliant. After accounting for the amendments made by the SARB, the Assessment Team did not identify any deviations.

### 2.1.1. Scope of application and transitional arrangements

Section grade	Compliant
Summary	<p>The scope of application and transitional arrangements were assessed as compliant. With regard to the scope of application, the domestic regulations apply the LCR standard to all banking entities on an aggregated basis within the banking group. However, the SARB has made provisions for exclusion of certain other financial institutions where they are assessed as non-significant exposures, as permitted by the LCR standard. Notwithstanding these exclusions, data showed that entities captured under the consolidated basis of the banking group range from 99.7% to 94% of total group assets for the largest domestic banks. The SARB has indicated that the scope of consolidation for regulatory purposes remains under review over 2015 (see Annex 12).</p> <p>Consistent with the revised Regulations issued on 10 April, these exposures are fully captured as potential contractual and non-contractual contingent liquidity outflows in the denominator. Therefore, after amendments, the Assessment Team has not identified these exclusions as a deviation in terms of paragraph 165.</p> <p>Nevertheless, as the SARB has indicated that the scope of application is under review, the Assessment Team suggests that this issue be followed up in future RCAPs (consistent with the recommendation in the RCAP on domestic adoption of the risk-based capital standard).</p>

### 2.1.2. High-quality liquid assets (numerator)

Section grade	Compliant
Summary	The adoption of the LCR is assessed as compliant. The SARB revised the regulatory framework to include more specific operational details on the computation of the LCR, via a Circular issued on 10 April (see Annex 5). After accounting for these amendments made by the SARB, the Assessment Team did not identify any deviations.

### 2.1.3. Outflows (denominator)

Section grade	Compliant
Summary	The adoption of the LCR is assessed as compliant. After accounting for the amendments made by the SARB (see Annex 5), the Assessment Team did not identify any deviations.

### 2.1.4. Inflows (denominator)

Section grade	Compliant
Summary	The adoption of the LCR requirements on inflows is assessed as compliant, as the Assessment Team did not identify any deviations.

## 2.2. LCR disclosure standard

Section grade	Compliant
Summary	The adoption of the LCR disclosure framework is assessed as compliant, as the Assessment Team did not identify any deviations.

## 2.3. Observations

Basel LCR paragraph no	Paragraphs 55–67: Treatment of jurisdictions with insufficient HQLA Annex 2: Principles for assessing eligibility for alternative liquidity approaches (ALA)
Reference in domestic regulation	na
Findings	<p>The SARB provided extensive verbal information on the analyses conducted by the SARB's banking supervision, financial stability and financial markets departments in assessing the sufficiency of high-quality liquid assets in the domestic market. Moreover, it provided additional information on its process of evaluating the various ALA options, and development of the adopted CLF approach.</p> <p>The Assessment Team did not undertake a formal assessment or form a view on South Africa's eligibility for adopting an ALA approach. The Assessment Team suggests that the Basel Committee provide further guidance on this process (see Annex 11).</p>
Basel LCR paragraph no	Paragraph 58: Potential options for alternative treatment: Option 1 – Contractual committed liquidity facilities from the relevant central bank, with a fee
Reference in domestic regulation	<p>Guidance note 6/2013</p> <p>Guidance note 8/2014</p> <p>Operational notice (Addendum 1)</p> <p>Bilateral contracts with commercial banks</p>
Findings	<p>The SARB has adopted the use of a CLF as a substitute for Level 2A assets due to a structural insufficiency of LCR-defined HQLA. In doing so, a number of documents were issued, including Regulations, reporting requirements, Guidance Notes and operational notices. Moreover, each bank was required to complete an application and, if accepted, to sign a bilateral contract with the SARB.</p> <p>The Regulations set out only high-level requirements on the CLF eligibility as Level 2A assets and banks' reporting requirements. The SARB's framework on the structure of the CLF, the collateral required, associated fees and other operational requirements was set out in Guidance Note 6, and later updated in Guidance Note 8. The detailed information required as part of the application process is set out in a template that must be completed by banks which apply for this treatment. Finally, banks enter into individual bilateral contracts with the SARB which outline, among other items, the bank's individual allotment, associated fees and other operational requirements.</p> <p>While Regulations and bilateral contracts are legally binding documents, Guidance Notes and operational notices are not. Nevertheless, the Assessment Team believes that the requirements in paragraph 58 are directed towards supervisors, rather than banks, so the detailed requirements do not need to be incorporated in the Regulations, and are also found in other legally enforceable documents. The Restricted Committed Liquidity Facility, a CLF available to all jurisdictions albeit with more stringent conditions on its parameterisation, is incorporated into the regulations (Annexure A) even though this is a supervisory option.</p> <p>Overall, the SARB has been assessed as compliant with paragraph 58.</p>

## Annexes

### Annex 1: RCAP Assessment Team and Review Team

#### Assessment Team Leader

Name	Affiliation
Mr Frank Pierschel	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)

#### Assessment Team Members

Name	Affiliation
Mr Tim Genovese-Frech	Swiss Financial Market Supervisory Authority FINMA
Mr Tomoyoshi Teramura	Japan Financial Services Agency

#### Supporting members

Name	Affiliation
Ms Barbara Pohl	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Ms Tania Rollert	Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin)
Ms Tamara Gomes	Basel Committee Secretariat

#### Review Team

Name	Affiliation
Mr Jonas Bernes Fentanes	CNBV, Mexico
Mr Karl Cordewener	Basel Committee Secretariat
Mr Graydon Paulin	Bank of Canada
Mr Sudarshan Sen	Reserve Bank of India
Mr Sunny Yung	Hong Kong Monetary Authority

## Annex 2: List of liquidity standards under the Basel framework used for the assessment

### Basel documents in scope of the assessment

- (i) *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools*, January 2013, including the frequently asked questions on Basel III's January 2013 liquidity coverage ratio (April 2014)
- (ii) *Liquidity Coverage Ratio disclosure standards*, January 2014

### Basel documents reviewed for information purposes

- (i) *Basel III: The Liquidity Coverage Ratio and liquidity risk monitoring tools*, January 2013 (part on liquidity risk monitoring tools)
- (ii) *Monitoring tools for intraday liquidity management*, April 2013
- (iii) *Principles for sound liquidity risk management and supervision*, September 2008

## Annex 3: Local regulations issued by the SARB for implementing Basel LCR standards

Overview of issuance dates of important liquidity rules

Table A.1

<b>Domestic regulations</b>	<b>Name of the document, version and date</b>
Domestic regulations implementing Basel III	Regulations relating to Banks, issued in terms of the Banks Act Implemented 1 January 2013 Government Gazette No. 35950 Amendment of Regulations relating to Banks, issued in terms of the Banks Act Issued 10 April 2015 Government Gazette No. 38682
Banks Act Directives	Directive 6/2014, 1 October 2014 Directive 7/2014, 28 October 2014 Directive 8/2014, 29 October 2014 Directive 11/2014, 12 December 2014
Guidance Notes	Guidance note 8/2014, 9 December 2014
Circulars	Circular 4/2015, 10 April 2015
Operational notice	Addendum 1, August 2013

Hierarchy of South African laws and regulatory instruments

Table A.2

<b>Level of rules (in legal terms)</b>	<b>Type/description</b>
Laws – Banks Act (No. 94 of 1990)	Enacted by Parliament
Regulations, including reporting requirements	Approved and issued by the Minister of Finance
Directives, Circulars and Guidance Notes	Issued by the Office of the Registrar

## Annex 4: Details of the RCAP assessment process

### A. Off-site evaluation

- (i) Completion of a self-assessment questionnaire by the SARB
- (ii) Evaluation of the self-assessment by the RCAP Assessment Team
- (iii) Independent comparison and evaluation of the domestic regulations issued by the SARB with corresponding Basel III standards issued by the BCBS
- (iv) Identification of observations
- (v) Refinement of the list of observations based on clarifications provided by the SARB
- (vi) Assessment of materiality of deviations for all quantifiable deviations based on data and non-quantifiable deviations based on expert judgment
- (vii) Forwarding of the preliminary draft report to the SARB

### B. On-site discussions and assessment

- (i) Discussion of individual observations with the SARB
- (ii) Meeting with select South African banks
- (iii) Discussion with the SARB and revision of findings to reflect additional information received
- (iv) Assignment of component grades and overall grade
- (v) Submission of the detailed findings to the SARB with grades
- (vi) Receipt of comments of the detailed findings from the SARB

### C. Review and finalisation of the RCAP report

- (i) Review of comments by the RCAP Assessment Team, finalisation of the draft report and forwarding to the SARB for comments
- (ii) Review of the SARB's comments by the RCAP Assessment Team
- (iii) Review of the draft report by the RCAP Review Team
- (iv) Review of the draft report by the Peer Review Board
- (v) Reporting of the findings to the SIG by the Team Leader
- (vi) Presentation of the report to the Basel Committee and its approval

## Annex 5: List of rectifications by the SARB

List of issues addressed by the SARB		Table A.3
Basel paragraph	Domestic rule-making	Brief description of forthcoming correction
Liquidity Coverage Ratio		
46, Annex 1	Reg 26(12)(b)(ii)_ Circular 4/2015	The SARB amended Regulation 26(b)(ii) to make explicit that high-quality liquid assets are those held on day 1 of the stress scenario. The SARB also issued Circular 4/2015 to incorporate paragraphs 4–6 of Annex 1 of the LCR rules text, outlining the clarifications and operational requirements to calculate the “unwind”. Both documents were issued 10 April 2015, effective immediately.
137	Reg26(12)(d)(xxiv)(B)(iv)	The SARB amended Regulation 26(12)(d)(xxiv)(B)(iv) to include the run-off rate for non-contractual contingent liquidity outflows associated with joint ventures or minority investments that are not consolidated under the scope of application. The amended Regulation was issued 10 April 2015, effective immediately.

## Annex 6: Assessment of the binding nature of regulatory documents

Table A.4

Criterion	Assessment
<p>(1) The instruments used are part of a well defined, clear and transparent hierarchy of legal and regulatory framework.</p>	<p>The SARB is responsible for bank regulation and supervision in South Africa. The purpose is to achieve a sound, efficient banking system in the interest of the depositors of banks and the economy as a whole. This function is performed by issuing banking licenses to banking institutions, and monitoring their activities in terms of the Banks Act (No. 94 of 1990 – Banks Act) and the Regulations relating thereto. “Bank” refers to a public company registered as a bank in terms of the Banks Act or registered branches of foreign institutions.</p> <p>The Banks Act is enacted by Parliament and provides enabling legislation that allows the Minister of Finance to prescribe minimum requirements and selected supervisory activities in the Regulations relating to Banks (“the Regulations”). The Regulations enable the BSD to put in place a supervisory review and evaluation process. High-quality liquid assets are defined in the Banks Act.</p> <p>The Regulations are supplemented by additional Circulars, Directives and Guidance Notes. Circulars, Directives and Guidance Notes are issued by the Registrar of Banks in terms of Section 6 of the Banks Act. Banks Act Circulars and Banks Act Directives are legally binding.</p> <p>Regulation 26, as amended, provides the detailed minimum requirements regarding the LCR as contained in the Basel LCR text. Banks Act Directives 6/2014, 7/2014, 8/2014 and 11/2014 were issued during 2014 to communicate areas of national discretion exercised by the BSD and further requirements regarding the application and calculation of the LCR.</p> <p>More specifically, Banks Act Guidance Note 8/2014 was issued during December 2014, replacing Guidance Note 6/2013, to communicate operational procedures regarding the application and lodging of collateral for a Committed Liquidity Facility (CLF), should a bank experience a shortfall in its LCR. Specific contractual arrangements are agreed upon on a bilateral basis with the relevant bank. The operational requirements of the CLF are set out in an Addendum to the Operational Notice which was published in August 2103 by the SARB’s Financial Markets Department. This addendum provides further guidance on the size of the facilities, commitment fee pricing, drawdown procedures, eligible collateral, market value adjustments (haircuts) and disclosure requirements. This Addendum to the Operational Notice is not considered to be legally binding but sets the parameters for negotiations on the bilateral contractual arrangements between the SARB and relevant banks wishing to utilise the CLF.</p>
<p>(2) They are public and easily accessible.</p>	<p>The Banks Act, Regulations, Banks Act Circulars, Banks Act Directives, Banks Act Guidance Notes, Exemption Notices and Financial Market Operational Notices are published in final form on the SARB’s website at <a href="http://www.resbank.co.za">www.resbank.co.za</a>.</p>
<p>(3) They are properly communicated and viewed as binding by banks as well as by supervisors.</p>	<p>In 2006, an Accord Implementation Forum (AIF) was constituted to assist with the implementation of Basel II standards. The AIF consisted primarily of the BSD and representatives of the banking industry who were organised in task groups to discuss amendments needed to implement Basel II fully. Task groups continued to discuss Basel 2.5 and III challenges and implementation.</p> <p>The amendments to the Banks Act and Regulations that gave effect to Basel 2, 2.5 and III standards were subject to public</p>

	<p>consultation, scrutiny by the National Treasury and the Standing Committee for the Revision of the Banks Act.</p> <p>Once the Banks Act and Regulations thereto are published as Government Notices in the Government Gazette, they become binding from the effective date of implementation stipulated in the Government Gazette.</p> <p>Guidance on market practises or matters of interpretation and application are addressed through the issuance of Banks Act Circulars and Guidance Notes. Directions to perform acts necessary to effect a required change are addressed through Directives, but only after public consultation.</p> <p>The above are specifically issued to banks, bank controlling companies, branches of foreign institutions and external auditors as applicable. Banks Act Circulars and Banks Act Directives are legally binding from date of publication, unless otherwise stated.</p>
(4) They would generally be expected to be legally upheld if challenged and are supported by precedent.	<p>Since the legal framework as described above is legally enforceable and subject to strict scrutiny and gives effect to internationally agreed standards/best practice, the SARB expects it will be upheld if challenged. There has been no legal challenge to date and none is expected.</p>
(5) Consequences of failure to comply are properly understood and carry the same practical effect as for the primary law or regulation.	<p>The Banks Act, Regulations thereto, Banks Act Directives, Banks Act Circulars and Exemption Notices are all legally enforceable. Contravention of any of these is an offence, punishable by penalty, fines and legal sanctions.</p> <p>Any instance of deviation from the minimum LCR requirements is viewed as an instance of non-compliance and will require a bank to take corrective actions.</p> <p>In addition to the criminal offence, there are also administrative sanctions under section 91A (1) which vest the Registrar with the power to impose a penalty not exceeding ZAR 10,000,000 for every day during which contravention or non-compliance with the Act continues if he/she believes that a bank or controlling company has contravened or failed to comply with the Act.</p>
(6) The regulatory provisions are expressed in clear language.	<p>In order to ensure that the legal framework is clear and concise, South Africa adopted Basel standards as a minimum. Minimum requirements were appropriately incorporated taking into consideration the South African domestic perspective and implications arising from all relevant local legislation, together with international agreed standards and best practice in other disciplines, such as International Financial Reporting Standards, corporate governance etc.</p> <p>Interactions with banks have indicated that the banking regulatory provisions are clearly understood. Should areas of uncertainty be identified as part of ongoing interaction with banks, the BSD may issue guidance on market practices or matters of interpretation and application. These are addressed through the issuance of Banks Act Circulars and Guidance Notes. The Financial Markets Department may also issue Operational Notices to provide further guidance on operational matters relating to the CLF.</p>
(7) The substance of the instrument is expected to remain in force for the foreseeable future.	<p>The Banks Act and Regulations thereto remain in force until amended through the appropriate legal channels.</p> <p>Banks Act Directives remain in force until withdrawn by the Registrar in writing.</p> <p>Circular 1 of each year reconfirms applicability of previously issued Banks Act Circulars and Directives.</p> <p>Guidance Note 1 of each year reconfirms applicability of previously issued Banks Act Guidance Notes.</p> <p>Operational Notices are also amended from time to time so as to remain fit for purpose and relevant.</p>

## Annex 7: Key liquidity indicators of the South African banking system

### Overview of banking system as at 31 December 2014

In ZAR millions

Table A.5

Size of banking sector; data as of 30 June 2014		
1. Total assets of all banks operating in the jurisdiction	4,178,699	
2. Total assets of all major locally incorporated banks	4,178,699	
3. Total assets of all locally incorporated banks to which liquidity standards under the Basel framework are applied	4,178,699	
Number of banks		
4. Number of banks operating in the jurisdiction	31 banks	
5. Number of global systemically important banks (G-SIBs)	0 (1 subsidiary of a G-SIB, 6 branches of foreign institutions regarded as G-SIBs)	
6. Number of domestic systemically important banks (D-SIBs)	na <sup>4</sup>	
7. Number of major locally incorporated banks	31 banks	
8. Number of banks required to implement Basel III liquidity standards	31 banks	
9. Number of banks required to implement domestic liquidity standards (if any)	31	
Implementation of liquidity standards under the Basel framework <sup>5</sup>		
	Unweighted	Weighted
10. Total HQLA	447,008	442,069
11. Level 1 HQLA	432,487	432,487
12. Level 2A HQLA	6,539	5,558
13. Level 2B HQLA	7,903	3,952
14. ALA HQLA	0	0
15. Total cash outflows	3,224,370	892,352
16. Retail and small business stable deposits	0	0
17. Retail and small business less stable deposits	660,845	66,084
18. Wholesale operational deposits	469,600	120,717
19. Wholesale unsecured non-operational funding	814,346	568,716
20. Secured funding	78,821	1,226
21. Debt issued instruments	3,234	3,234
22. Other contractual outflows	536,839	63,031
23. Contingent funding obligations	660,685	69,344
24. Total cash inflows	440,862	312,754
25. Secured lending	53,731	9,445
26. Fully performing unsecured loans	345,983	273,738

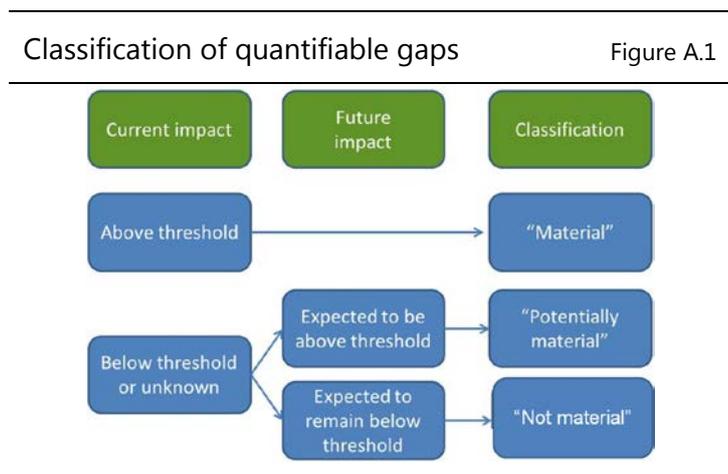
<sup>4</sup> The D-SIB framework has been implemented, but corresponding data are not publicly available.

<sup>5</sup> Based on a sample of nine banks.

27. Other cash inflows	41,148	29,569
26. Liquidity Coverage Ratio (average of sample)		76%

## Annex 8: Materiality assessment

The assessment of materiality distinguished between quantifiable and non-quantifiable gaps. For the South African RCAP, an attempt was made to quantify the impact of all quantifiable gaps for each bank in the sample affected by the gap. In total, one gap/difference was assessed based on bank data and data available to the SARB authorities. In those cases where the computation of the impact was not straightforward, the computation erred on the conservative side. Where no data were available to quantify gaps, the review team relied on expert judgment. Following this approach, an attempt was made to determine whether gaps were “not material,” “material” or “potentially material”.



Number of gaps / differences by component Table A.6

Component	Non-material	Material	Potentially material
Liquidity Coverage Ratio	0	0	0
Scope of application	1	0	0
Transitional arrangements	0	0	0
High-quality liquid assets (numerator)	0	0	0
Outflows (denominator)	0	0	0
Inflows (denominator)	0	0	0
LCR disclosure standard	0	0	0

Materiality is defined based on quantitative benchmark thresholds (for the quantifiable gaps) and expert judgment (for the non-quantifiable gaps). See Section 2 with the detailed assessment findings for further information.

## Annex 9: South Africa’s implementation of Basel III liquidity monitoring tools and Basel guidance on monitoring tools for intraday liquidity management

### General monitoring

In addition to the detailed information required to monitor compliance with the LCR, the BSD has historically implemented a liquidity risk return (Form BA 300), submitted to it by all banks on a monthly basis as per a standard reporting template, to monitor liquidity risk exposures of individual banks. These liquidity risk returns include the measurement of the contractual mismatch, depositor concentration, sources of stress funding and the foreign exchange maturity ladder.

### Reporting on and monitoring of contractual mismatches

The contractual mismatch captures the contractual mismatches per various time buckets and includes contingent liquidity risk items (ie off-balance sheet positions). Further to the contractual position the BSD also monitors the behavioural/business-as-usual mismatches and an idiosyncratic stress scenario.

An example of typical information received on contractual mismatches as reported in Form BA 300 is shown below:

<b>Contractual balance sheet mismatch</b>	<b>Next day</b>	<b>2 to 7 days</b>	<b>8 days to 1 month</b>	<b>More than 1 month to 2 months</b>	<b>More than 2 months to 3 months</b>
<b>Contractual maturity of assets</b>					
Advances					
Trading, hedging and other investment instruments					
Other assets					
<b>Contractual maturity of liabilities</b>					
Stable deposits					
Volatile deposits					
Trading and hedging instruments					
Other liabilities					
<b>On-balance sheet contractual mismatch</b>					
<b>Cumulative on-balance sheet contractual mismatch</b>					
<b>Off-balance sheet exposure to liquidity risk</b>					
<i>Of which:</i>					
Liquidity facilities provided to off-balance sheet vehicles					
Undrawn commitments					
Unutilised portion of irrevocable lending facilities					

<b>Contractual balance sheet mismatch</b>	<b>Next day</b>	<b>2 to 7 days</b>	<b>8 days to 1 month</b>	<b>More than 1 month to 2 months</b>	<b>More than 2 months to 3 months</b>
Unutilised portion of irrevocable letters of credit					
Indemnities and guarantees					

## Reporting and monitoring liquidity on a daily basis

An example of daily monitoring of liquidity can be seen below. Form BA 325 is submitted daily by banks in order to monitor the liquidity and market risk positions of all banks by the SARB.

<b>Summary of selected information</b>	<b>Total</b>
<b>Liquidity risk</b>	
SARB repo participation	
Liquid assets	
Held on preceding day	
Month to date average held	
Requirement (item 14 of Form BA 310)	
Liquidity coverage ratio (LCR)	
High-quality liquid assets	
Net cash outflow	
LCR (%)	

## Reporting on and monitoring of potential sources of stress funding

Banks are required to submit information relating to potential sources of stress funding, which includes excess liquid assets held, investment securities classified as available for sale, secured and unsecured funding lines.

An example of typical information received on potential sources of stress funding as reported in Form BA 300 is shown below:

<b>Available sources of stress funding</b>	<b>Next day</b>	<b>2 to 7 days</b>	<b>8 days to 1 month</b>	<b>More than 1 month to 2 months</b>	<b>More than 2 month to 3 months</b>
Realisable by forced sale					
Investment securities classified as available for sale					
Unencumbered trading securities					
Assets available for securitisation vehicles					
FX market liquidity					
Available repo facilities					
Ring-fenced portfolio of prudential liquid securities					
25% of liquid assets held					
Estimated unutilised interbank funding capacity					

Unsecured funding lines					
Secured funding lines					
Drawdown capacity in respect of call loans					
Other funding					
<b>Total available liquidity</b>					

## Reporting on and monitoring of deposit concentration

In measuring deposit concentration, the BSD has historically received information on a monthly basis on the top 10 deposits received by a bank from depositors. The BSD also monitors the foreign exchange maturity mismatches per significant currency (with exposures to USD, EUR and GBP as a minimum) in specific time buckets.

An example of typical information received on deposit concentration as reported in Form BA 300 is shown below:

<b>Concentration of deposit funding</b>	<b>Time buckets</b>
Funding supplied by associates of the reporting bank	
Ten largest depositors	
Ten largest financial institutions funding balances	
Ten largest government and parastatals funding balances	
Negotiable paper funding instruments	

The measurement of unencumbered assets has, to a limited extent, been included as part of the monitoring of the Net Stable Funding Ratio. However, as part of future regulatory amendments the measurement of unencumbered assets will be expanded as well as the measurement of significant funding instruments.

## Annex 10: South Africa's implementation of the *Principles for sound liquidity risk management and supervision*

This annex provides a qualitative description of the implementation of the Basel *Principles for sound liquidity risk management and supervision* in South Africa's regulation. The principles are not part of the formal RCAP assessment, and no grade is assigned. This annex serves for information purposes only. Principles 1–17 are implemented in South Africa through The Banks Act and the Regulations.

### Fundamental principle for the management and supervision of liquidity risk – Principle 1

The first principle states “A bank is responsible for the sound management of liquidity risk. A bank should establish a robust liquidity risk management framework that ensures it maintains sufficient liquidity, including a cushion of unencumbered, high quality liquid assets, to withstand a range of stress events, including those involving the loss or impairment of both unsecured and secured funding sources. Supervisors should assess the adequacy of both a bank's liquidity risk management framework and its liquidity position and should take prompt action if a bank is deficient in either area in order to protect depositors and to limit potential damage to the financial system.”

The Banks Act, 1990: Section 64A(2) requires banks to have a risk and capital management committee to assist the board of directors to evaluate risk policies, procedures, practices and controls applied within that bank or controlling company in the day-to-day management of its business. The committee should also assist in developing a risk mitigation strategy, identifying concentration, identifying key risks and monitoring performance indicators. Regulation 39(3)(k) states that the board of directors is responsible for an adequate and effective process of corporate governance, which includes the maintenance of effective risk management and capital management by a bank. The conduct of the business of a bank entails the ongoing management of risk which may arise from the bank's on-balance sheet or off-balance sheet activities including liquidity risk. The BSD receives the liquidity position of a bank (Form BA 300) – Regulation 26 – on a monthly basis and requires both on- and off balance sheet information to be provided on various aspects of liquidity risk. Banks provide the BSD with a daily liquidity report (Form BA 325) – Regulation 29 – which requires daily reporting of a bank's liquid asset position as well as a daily LCR.

### Governance of liquidity risk management – Principles 2–4

According to regulation 39, in order to achieve the objective relating to the maintenance of effective risk management and capital management, every bank shall have in place comprehensive risk management processes, practices and procedures, and board-approved policies to identify, measure, monitor, control, price, mitigate and communicate any risk. In the case of liquidity risk, a bank shall be sufficiently robust to ensure that it conducts comprehensive cash flow forecasting, have appropriate limits in respect of funding sources, conduct stress testing, maintain contingency funding plans and maintain a sufficient cushion of liquid assets. As a minimum, the board of directors and senior management of a bank shall possess detailed knowledge of all major business lines; ensure adequate management information systems to facilitate proactive management of risk; and ensure that, before embarking on new activities,

investing in new instruments or introducing products new to the bank, that the bank's exposure to the new instruments, products or activities have been identified, considered and reviewed.

## Measurement and management of liquidity risk – Principles 5–12

Regulation 26 deals with the measuring, monitoring and controlling of liquidity risk as well as projecting cash flows from assets and liabilities over appropriate time horizons. Banks are also required to monitor their exposures and funding needs at the level of each material individual legal entity, foreign branch or subsidiary, and the group as a whole, taking into account any relevant legal, regulatory or operational limitation that may affect the transferability of liquidity. A bank shall ensure appropriate diversification in both the tenor and source of its funding. Banks shall ensure that their policies, processes, systems and procedures relating to liquidity risk management are sufficiently robust to effectively manage the banks' ongoing liquidity needs, including any relevant intraday liquidity requirements and collateral positions. Stress testing shall be sufficiently robust to identify events or influences that may have a material impact on the bank's exposure to risk. The bank shall have in place sufficiently robust early warning indicators to identify the emergence of increased risk or vulnerabilities in its liquidity position or funding needs. The results of stress tests or scenario analysis shall form the basis for taking remedial or mitigation action to limit the bank's liquidity exposure, to build up a liquidity cushion in a timely manner, and to adjust in a timely manner the bank's liquidity profile according to the bank's risk tolerance approved by the board of directors. Regulation 36(8)(b)(xi), in addition to the BA 600 return, states that a bank shall submit in writing to the Registrar qualitative information relating to the strategy adopted by the relevant bank or controlling company in respect of contingency planning, including the extent to which contingency planning is centralised or managed on a business or legal entity basis.

## Public disclosure – Principle 13

According to Regulation 43 relating to public disclosure, a bank shall disclose in its annual financial statements and other disclosures to the public reliable, relevant and timely qualitative and quantitative information that enables users of that information, among other things, to make an accurate assessment of the bank's financial condition, including its capital adequacy position and financial performance, business activities, risk profile and risk management practices.

## The role of supervisors – Principles 14–17

The BSD conducts regular liquidity on-site meetings as well as recovery and resolution planning meetings with banks. In these meetings, the BSD reviews, among other things, the accounting policies, stress testing, contingency planning, reporting and independent reviews of banks. Additionally, monthly and daily analyses of statutory regulatory reports and funding levels are examined to ensure regulatory compliance.

## Annex 11: Areas for further guidance from the Basel Committee

### Peer review for eligibility to adopt ALA approaches

Paragraph 55 of the LCR standard notes that eligibility for alternative treatments for holding in the stock of HQLA will be determined through an independent peer review process overseen by the Committee. As noted in Section 2.3 above, the Assessment Team did not assess South Africa's eligibility for ALA treatments. Further guidance from the Committee on the process for this peer review would be useful.

### Supervisory oversight of banks' processes for distinguishing between different categories of deposits

Sections B. 1. (i) and (ii) of the Basel Committee's LCR framework outline various classes of deposit funding. In some cases, the LCR standard requires banks to have processes in place to distinguish between classes of deposits, or to identify excess deposits, eg paragraph 97.

The BSD authorities provided extensive verbal information on the analytical work completed in order to distinguish between different classes of deposits for the purposes of domestic rule-making, including stable and less stable deposits, and operational deposits. In some cases, even where they accepted banks' methodologies, they added an additional layer of conservatism into the run-off rate. They also explained their supervisory processes for monitoring banks' methodologies of identifying excess deposits.

Given the scope for differing methodologies and supervisory approaches, it would be useful to provide for greater information-sharing amongst supervisors.

## Annex 12: List of issues for follow-up by future RCAP assessments

The Assessment Team identified two issues for follow-up by future RCAP assessments:

### LCR scope of application

The domestic regulations apply the LCR standard to all banking entities on an aggregated basis. However, the SARB excludes certain other financial institutions where they are assessed as non-significant exposures. The SARB has indicated that the scope of consolidation for LCR regulatory purposes remains under review, which will be completed by end-2015.

### LCR disclosure requirements

While the SARB has implemented the LCR disclosure standard, the prescribed template has not been transcribed into domestic regulations. The SARB has indicated that this will be incorporated in 2015.

## Annex 13: Areas where the SARB requirements are more conservative than the Basel minimum standards

In one area, the SARB authorities believe that they have adopted a stricter approach than the minimum standards prescribed by the Basel framework. The information in this annex has been provided by the SARB and has not been cross-checked or assessed by the RCAP Assessment Team. It should be noted that this areas has not been taken into account as a mitigating factor in the overall assessment of compliance.

- The BSD authorities believe that they have adopted a stricter approach than the minimum standards prescribed by Basel for the implementation of the LCR only in the instance of the definition of small business customers. The South African limit is ZAR 7.5 million (approximately EUR 532,000 as of December 2014).

## Annex 14: Implementation of LCR elements subject to prudential judgment and discretion in South Africa

The following tables provide information on elements of LCR implementation that are subject to prudential judgment and national discretion. The information provided helps the Basel Committee to identify implementation issues where clarifications and (additional) FAQs could improve the quality and consistency of implementation. It should also inform the preliminary design of any peer comparison of consistency across the membership that the Committee may decide to conduct, in similar fashion to the studies on risk-weighted asset variation for the capital standards.

Para	Description	Implementation by the SARB
24f.	Treatment of the concept of "large, deep and active markets"	This concept is included in our regulatory framework as part of the definitions of the various qualifying marketable securities. Currently no further guidance has been provided due to the concentration of HQLA in South African sovereign securities and in the sovereign debt of other African jurisdictions where South African banks are operating.
50	Treatment of the concept of "reliable source of liquidity"	This concept is included in our regulatory framework as part of the definitions of the various qualifying marketable securities. Currently no further guidance has been provided due to the concentration of HQLA in South African sovereign securities.
52	Treatment of the concept of "relevant period of significant liquidity stress"	This concept is included in our regulatory framework as part of the definitions of the various qualifying marketable securities. Currently no further guidance has been provided due to the concentration of HQLA in South African sovereign securities.
74–84	Retail deposits are divided into "stable" and "less stable"	Currently, South Africa does not have deposit insurance, so all deposits are classified as "less stable".
83, 86	Treatment of the possibility of early withdrawal of funding with maturity above 30 days (para 83 – retail deposits; para 86 – wholesale funding)	For retail deposits, the BSD has defined the exceptional circumstances of financial hardship that would allow for early breakage without a penalty being applied. This is contained in Directive 7/2014.
90–91	Definition of small business customers' exposure is based on nominal EUR amount (1 million)	The BSD has interpreted the Basel text as being clear that the conversion of the EUR amount should be aligned with the conversion applied to small business customers in the capital calculations for credit risk. Therefore, the BSD has converted it to ZAR 7.5 million. A process has been initiated to review the conversion with a view of increasing the ZAR limit.
94–103	Deposits subject to "operational" relationships	Banks were expected to apply for the utilisation of the beneficial classification of deposits as operational deposits, on an individual bank basis, and to specify the types of products included in the classification and to have a methodology in place for calculating the amount that would be deemed to be excess to

Elements requiring judgment (non-comprehensive list)

Table A.7

Para	Description	Implementation by the SARB
		the operational needs of the client.
131f.	Definition of other financial institutions and other legal entities	For this purpose, banks utilise the "Institutional Sector Classification Guide for SA" <sup>6</sup> published by SARB's Research Department to identify the classification of entities. The classification of other legal entities is treated as a catch-all category for all entities that could not be classified according to the specified categories in the LCR framework.

Elements left to national discretion (non-comprehensive list)

Table A.8

Para	Description	Implementation by the SARB
5	These two standards [the LCR and NSFR] are comprised mainly of specific parameters which are internationally "harmonised" with prescribed values. <i>Certain parameters, however, contain elements of national discretion to reflect jurisdiction-specific conditions. In these cases, the parameters should be transparent and clearly outlined in the regulations of each jurisdiction to provide clarity both within the jurisdiction and internationally.</i>	Items of national discretion exercised by the BSD are contained and published in Banks Act Directive 7/2014.
8	Use of phase-in options	South Africa will follow the internationally agreed phase-in period. This has been incorporated in Bank Act Directive 8/2014 and into the Regulations as amended.
11	The Committee also reaffirms its view that, during periods of stress, it would be entirely appropriate for banks to use their stock of HQLA, thereby falling below the minimum. Supervisors will subsequently assess this situation and will give guidance on usability according to circumstances. <i>Furthermore, individual countries that are receiving financial support for macroeconomic and structural reform purposes may choose a different implementation schedule for their national banking systems, consistent with the design of their broader economic restructuring programme.</i>	South Africa does not fall within this category of countries receiving financial support for macroeconomic and structural reforms.
50b	Eligibility of central bank reserves	The BSD views central bank reserves as drawable during periods of stress and has therefore included them as part of Level 1 assets. This is contained in Banks Act Directive 7/2014.

<sup>6</sup> Available at [www.resbank.co.za/Publications/Guides/Pages/Institutional-Sector-Classification-Guide-for-SA---2011.aspx](http://www.resbank.co.za/Publications/Guides/Pages/Institutional-Sector-Classification-Guide-for-SA---2011.aspx).

Elements left to national discretion (non-comprehensive list)

Table A.8

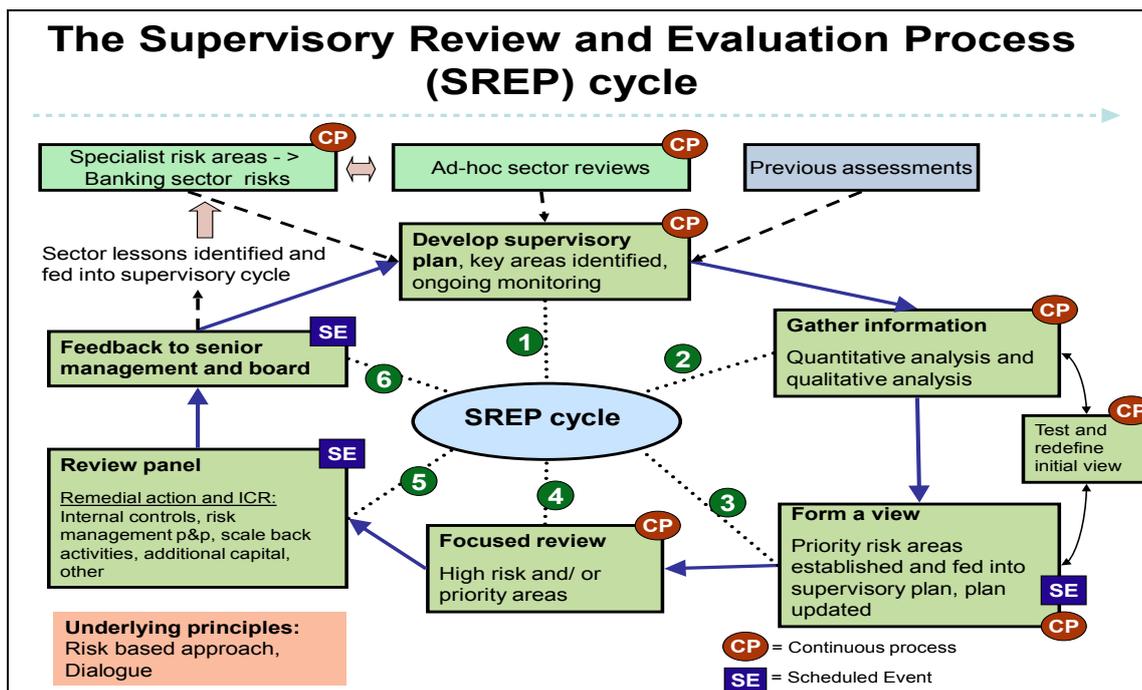
Para	Description	Implementation by the SARB
50c	Marketable securities that are assigned a 0% risk weight under the Basel II Standardised Approach for credit risk	South Africa exercised this national discretion in the Basel II framework; therefore, South African sovereign securities follow the criteria in para 50(d) of the LCR framework.
53–54	Eligible Level 2B assets	South Africa has included Level 2B assets in its regulatory framework, although the actual assets that would qualify are limited in supply. This is contained in Banks Act Directive 7/2014.
54a	Provision relating to the use of restricted contractual committed liquidity facilities (RCLF) <sup>7</sup>	South Africa has made a provision for the RCLF in its regulatory framework. However due to the implementation of the CLF, the RCLF will currently not be made available to banks.
55f.	Treatment for jurisdictions with insufficient HQLA (subject to separate peer review process)	South Africa has exercised ALA options 1 and 2, ie the CLF and limited use of additional foreign currency Level 1 HQLA.
68	Treatment of shariah-compliant banks	na
78	Treatment of deposit insurance	na
79f	Categories and run-off rates for less stable deposits	Provision made in the regulatory framework, but the discretion has not been exercised.
123	Market valuation changes on derivative transactions.	The BSD did not deviate from the LCR framework, but provision has been made in the regulatory framework for possible deviations.
134–140	Run-off rates for other contingent funding liabilities.	Run-off rates ranging from 2.5% to 50% assigned to these items, as contained in Banks Act Directive 7/2014.
160	Weight assigned to other contractual inflows	Currently, no other contractual inflows have been identified.
164–165	Determination of scope of application of LCR (whether to apply beyond “internationally active banks” etc) and scope of consolidation of entities within a banking group	The LCR is applied to all registered banks and foreign branches operating within South Africa. For consolidation it is applied to all banking entities within the group on an aggregated basis.
168–170	Differences in home/host liquidity requirements due to national discretions	This is not a significant issue, because the majority of the banking operations of South African banks outside South Africa are in other African countries, which in most cases have not implemented the LCR. Therefore, banks have to default back to the South African requirements.
Annex 2	Principles for assessing eligibility for alternative liquidity approaches (ALA)	This forms part of the process to reassess the CLF size, pricing and other relevant characteristics.

<sup>7</sup> See [www.bis.org/publ/bcbs274.htm](http://www.bis.org/publ/bcbs274.htm).

## Annex 15: Summary of Pillar 2 supervisory review

The Bank Supervision Department's (BSD) methodology is captured in the Supervisory Review and Evaluation Process (SREP) manual. The SREP manual consists of six main stages that take place as a continuous and ongoing process as well as scheduled events. The SREP manual is an overarching manual for both on- and off-site analysis.

High-level overview of the SREP cycle:



### Stage one

A sound, robust and well-considered supervisory plan is a necessary prerequisite to an effective SREP and entails continuous analysis and planning.

### Stage two

The SREP includes a review of data submitted by banks by utilising time series analysis, automated key stats, trigger reports and automated graphical analysis. The frequency and intensity of the supervision of banks are determined by the relevant entity's risk assessment referred to as the Management Information Report (MIR) and the Risk Review document and would also feed into stage 1 of the SREP, that is, "supervisory planning".

Off-site supervision includes conducting meetings (as part of the supervisory programme) with the banks' board of directors, management, business unit heads, internal audit, compliance officer and

external auditors to gather information about a bank's risk profile, business/strategic plan, budgets, strategic objectives, corporate governance and compliance risks, amongst other items. Throughout the cycle a risk-based supervisory approach is followed which is a structured forward-looking approach process designed to identify key risk factors to which individual banks or the entire banking sector are exposed. The "forward-looking" approach includes presentations by the board on a bank's short- and long-term strategy, the bank's projections for the next 12 months and the BSD's views on the aforementioned information.

### Stage three

Information gathered from banks would be assembled, and then analysed and synthesised in order to form a view of the bank. The focus is on materiality and risk. The rating assigned to a particular bank takes into account the entity's sector relevance, an assessment of key risk areas, information obtained from interactions with the bank, key focus areas, corporate governance, detailed analysis of capital adequacy and liquidity as well as issues of concerns. Key supervisory focus areas are identified throughout the SREP cycle.

### Stage four

Internal liquidity adequacy assessment process (ILAAP): Currently liquidity is assessed as part of the ICAAP reviews. Ongoing monitoring, specific on-site thematic reviews on liquidity risk as well as liquidity simulation exercises enable the BSD to form a view regarding liquidity management and the adequacy of the liquidity position and funding profile of each institution. The thematic reviews cover liquidity risk management on an end-to-end basis, including governance, policies and procedures, risk appetite and limits, pricing of liquidity risk, dependence on foreign currency funding, funding concentration and key funding sources, collateral management and issues surrounding the implementation of the Basel III liquidity measures.

### Stage five

A panel review process is followed whereby a panel, consisting of executives from the BSD, risk specialists and analysts review the procedural and substantive correctness of the SREP, as well as of the conclusions reached and recommendations made. The conclusions reached and recommendations generated during the "forming-of-a-view" stage (stage 3) and the focused review stage (stage 4) by the analyst (in conjunction with the relevant risk specialists, if applicable) forms the basis for the panel review. The BSD, as far as possible, needs to ensure that institutions have adequate capital and liquidity commensurate to overall strategy, risk appetite, assessed risks including stress and risks revealed by stress testing.

## Stage six

Conclusions and recommendations reached in stage 5 are fed back to the bank's board of directors, risk committee, audit committee and senior management. Industry lessons identified are fed back into the macro-surveillance cycle and report, and may warrant the conducting of ad hoc sector reviews.

Notwithstanding the above process, it should be noted that it is prescribed in Regulations that whenever the Registrar is of the opinion that a bank's:

- calculated aggregate risk exposure does not sufficiently reflect:
  - the bank's actual risk profile;
  - the factors external to the bank, such as the effect of business cycles;
  - the risk relating to a particular type of exposure such as credit risk, market risk or operational risk;
  - the risk relating to a group of exposures such as corporate exposure or retail exposure;
- qualifying capital and reserve funds are likely to be overstated;
- policies, processes and procedures relating to its risk assessment are inadequate;
- policies, processes and procedures relating to compensation or remuneration are inadequate; and
- internal control systems are inadequate,

the Registrar, among other things, may require a bank to maintain additional capital, to make prescribed deductions against qualifying capital and reserve funds, to strengthen the bank's risk management policies and processes or to duly align the bank's compensation or remuneration policies, processes or procedures with the bank's relevant exposure to risk. The Regulations also make provision for the Registrar to specify higher haircuts and run-off rates or lower inflow factors for the LCR calculations.